

NEWSLETTER

INTERNATIONAL

 ENGLISH VERSION

RUSSIA



BASIC CONDITIONS FOR INVESTING IN RUSSIA



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OPEN ARMS AND REDUCED COSTS: INVESTORS FEEL FAIR WIND

There has been very little positive news about the Russian economics within the last two years. The gross domestic product grew by mere 0.6 percent in 2014 and lost 3.8 percent by the end of September of the current year. During the first six months of 2015, the gross fixed capital formation reduced by 5.4 percent in spite of the import replacement policy of the Russian Government, while it got 2 percent lower within the previous year.

In the meantime, analysts assume that the Russian economic downturn has already reached its lowest point. However, no quick recovery seems to be likely now. Unlike the way it happened in 1998 and 2009, one may only hope for a slowly growing economic performance. According to a Raiffeisenbank report as of the mid-November, the rouble might settle down at the EUR rate of RUR 65 = EUR 1.

Discussions with company representatives show that many businesses now give up cost optimization they have been carrying out in 2015 and 2014, and launch expansive strategies again. Alongside with active market development, manufacturing enterprises consider benefiting from at least partial localization of production in Russia.

Many factors stand for such measure:

1. Due to the import replacement policy (see also our newsletter for June), the Russian policy systematically gives priority to products that are "made in Russia", instead of imported ones. This happens due to restrictions to state tenders or import prohibitions, e.g. in the field of food products. Companies that have production sites in Russia thus might take away market shares of their competitors as long as their production in Russia complies with the strict legal requirements to the production depth and local value added activities.
2. Since 2014, the Russian government has been parading its close relations with China in order to compensate for the reluctance of Western companies by Chinese direct investments. However, the hopes for a strong engagement of Chinese companies have not come true yet, except for a few large power and infrastructure projects (the economic value for the Russian economy of which was a subject of controversial debates even in the Russian mass media). Probably, this context shall be considered alongside with the fact that the Russian policy has once again done a lot for European companies. For example, at a conference held early October, nine top-level representatives of the Russian Regions presented advantages of their Regions to German enterprises. Denis Manturov, the Russian Minister for Industry and Trade, visited Berlin in November. Both events were held to start negotiations with prospective investors and to improve the perception of the Russian economy by German entrepreneurs. "Russia welcomes European enterprises", this was the clear message of the events.

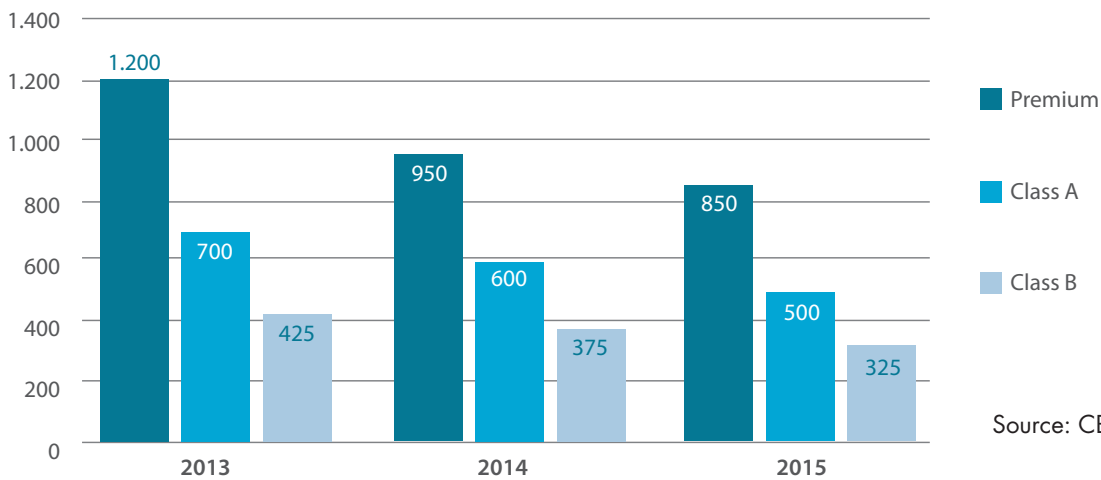


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3. Because of the rouble decay, there are plenty of attractive opportunities for the companies who want to increase their presence in Russia. The office rent in Moscow rapidly increased after the crises in 2009 – and fell down at the same speed in 2014.

Office Rental Fees in USD (Moscow, sq.m/year, without VAT and charges)

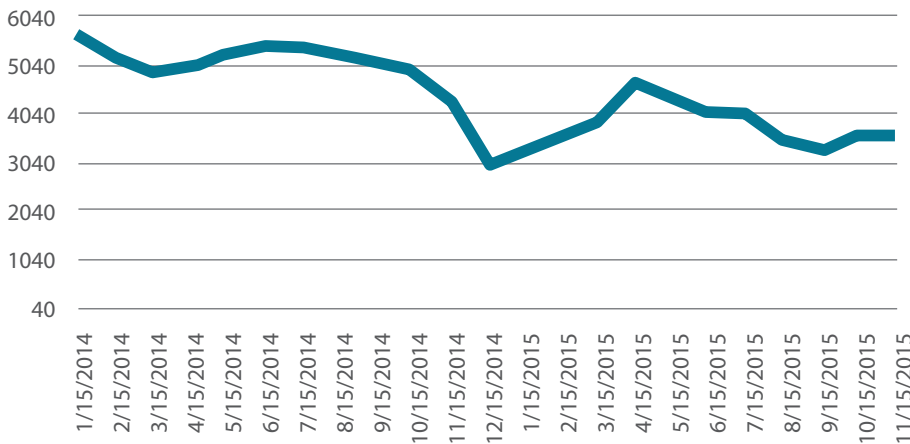


Source: CBRE

The sinking demand makes lessees make more and more attractive offers. Almost always they are ready to give discounts to the previously announced rents. Moreover, more and more lessors agree on long-term agreements with fixed terms and conditions instead of 11-month agreements they used to enter into before.

4. The changing foreign exchange rate has similar influence over the labour costs. A gross monthly salary of RUR 250,000 amounted to EUR 5,556 mid-January 2014 and EUR 3,482 in November 2015.

Overview: 250.000 RUR in Euros



Source: Central Bank of RF

Russian wages in roubles showed a relative growth of 9 and 2 percent in 2014 and by the end of June 2015, respectively. Still, it is a clear decline in the light of the inflation rate of 11.4 or 9.8 percent - and the official inflation rate only partially reflects the real price increase.

In the past, so called "job hopping" was an issue in Russia but not now: employee loyalty significantly increased after employers had dismissed a lot of workers and the demand for human resources had become very small.

International SMB companies, for whom start-up costs used to be rather high, right now face attractive terms and conditions to increase their presence in Russia. Enterprises intending to localize their production especially profit from small salary costs: in some regions they have already reached the Chinese level.

„INVESTMENT DECISIONS ARE NOW BASED ON OPPORTUNITIES TO UTILIZE LOW FACTOR COSTS“

For two years, nearly no good news has come from Russia. Why shall enterprises come to this market now?

The long-term backgrounds that speak for engagement on the Russian market are still present despite the current economic and politic fluctuations. The country has a large middle class with nearly the same consumption preferences as in Western Europe. Strong demand for products is present in many industrial and technology fields. At the same time, in some branches local competitors are nearly absent or very weakened. The low rouble exchange rate provides for a stronger market position at lower entry costs. Therefore, many factor costs appear to be more attractive, e.g. labour and rental costs, or energy and material costs. Nowadays, smaller investments might become a perfect platform allowing for a fast growth in the conditions of the incipient conjuncture.

For which branches is the Russian market most interesting in the given circumstances?

I still see excellent chances in the field of FMCG, personal consumption goods, and retail trade.

Moreover, the industry has a specific demand. There are many opportunities for the existing Russian production enterprises, especially in the light of the political urge for localization.

What are advantages of localized production in Russia?

Many enterprises exporting their products to Russia are faced with the dilemma of whether or not to localize component production in the light of the strongly deteriorated RUR foreign exchange rate and increasing product prices for the Russian consumers caused thereby.

INTERVIEW



Dr. Reinhard Kohleick

Senior Advisor,
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Dr. Kohleick has been working as Managing Director of Quadriga Capital Russia for 18 years. Now he actively participates in different technology startups as investor and supervisory board member.

Unlike before, such decision is made not based on high growth rates of the market but on using the current low factor costs that even might last in the middle-term perspective.

If you like to fully or partially set up production in Russia you are going to be competitive and make a foundation for future growth.

When is it reasonable to localize production via license agreement or other models of cooperation with Russian companies instead of establishing a subsidiary in Russia?

A joint-venture or a license agreement might be reasonable. However, such a step requires determination of clear partnership rules, and shall be based on verifiable trust and explicit contractual agreements.

Anyway, one needs to keep their key competences in-house to remain a partner of such a bound in a long-term prospective. These key competences might be for example distribution, brand image, supply chain, product registration and licenses.



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